27 Estimated Tax Payments

Income taxes are collected on a pay-as-you-go basis through withholding on wages and pensions, as well as quarterly estimated tax payments on other income. Where all or most of your income is from wages, pensions, and annuities, you will generally not have to pay estimated tax, because your estimated tax liability has been satisfied by withholding. But do not assume you are not required to pay simply because taxes have been withheld from your wages. Always check your estimated tax liability. Withholding may not cover your tax; the withholding tax rate may be below your actual tax rate when considering other income such as interest, dividends, business income, and capital gains.

Your estimated tax must also include liability for self-employment tax and alternative minimum tax (AMT).

You have to make quarterly estimated tax payments during 1997 if your estimated tax liability, after accounting for withholding taxes, is at least $500 and the withholding taxes will not be at least 90% of your 1997 tax liability, or 100% or 110% of your 1996 tax liability. The 100% test applies if your 1996 adjusted gross income is $150,000 or less ($75,000 or less if married filing separately in 1997). The 110% test applies if 1996 adjusted gross income exceeds these amounts.

Failure to pay a required estimated tax installment is subject to a penalty based on the prevailing IRS interest rate applied to tax deficiencies.

Estimated tax payments are made with vouchers included with Form 1040-ES. Residents of Puerto Rico during the entire taxable year also use Form 1040-ES. Nonresident aliens use Form 1040-ES (NR).

¶27.1 Estimating Your Tax

There are three stages of reviewing your estimated tax liability:

1. **When you have computed the exact amount of your 1996 tax liability on your 1996 return**. You can now determine whether your 1996 withholdings plus estimated tax installments were at least 90% of your final 1996 tax, shown on Line 51 of Form 1040 or Line 28 of Form 1040A. If they were, you are not subject to a 1996 penalty. If they were not, you are subject to a penalty unless your estimated tax payments were at least 100% or 110% of the final 1995 tax on a return covering a full 12 months. The 100% test applies if your 1995 adjusted gross income was $150,000 or less ($75,000 or less if married filing separately for 1996). If your 1995 adjusted gross income was more than $150,000 (or more than $75,000 if married filing separately for 1996), the 110% test applies.

   If you underestimated your 1996 liability because of an unexpected increase in income during 1996, or if you did not earn income evenly throughout 1996, such as where you operated a seasonal business, you may be able to lower or eliminate the penalty by using the *annualized income installment method.* Under this exception, you may avoid a penalty for an estimated tax installment by figuring the installment that would be due if the income (and deductions) earned before the date for the installment were *annualized*. Form 2210 and IRS Publication 505 have worksheets for applying the annualized income exception. The computation is complicated and its use may be discouraged by the complexity, despite the potential benefits.
2. **When you make an estimate for 1997**. You will generally do this after completing your 1996 return. In planning your 1997 payments, you do not want to pay more than necessary to avoid a penalty. If you expect your 1997 income and deductions to be about the same as in 1996, apply 1997 tax rates (which will be in the Supplement) to your 1996 taxable income, and base your 1997 withholdings and quarterly estimated tax installments on 90% of that tax. If you were subject to self-employment tax or alternative minimum tax in 1996, add 90% of such taxes to your 1997 estimate.

   If you are uncertain of the amount of your 1997 income and deductions, you can play it safe and avoid a possible penalty in 1997 by having withholdings and quarterly estimated tax installments equal 100% of your 1996 tax liability, provided you filed a 1996 return covering a full 12 months. The 100% requirement is increased to 110% if adjusted gross income for 1996 exceeds $150,000, or $75,000 if you are married filing separately in 1997.

   If an accurate estimate for 1997 is possible, it is generally advantageous to base your estimated payments on the 90% test rather than the 100% or 110% prior year test, as these will probably result in an overestimation of your liability unless the 1997 liability turns out to be substantially larger than the 1996 liability.

   You may use the worksheet and the tax rate schedule included in the 1997 Form 1040-ES to figure your estimated tax liability and the required annual payment to avoid a penalty under either the 90% current year or 100% or 110% prior year liability tests just discussed. Reduce your 1997 estimated tax liability by projected 1997 withholdings from wages, pensions, and annuities. If after withholdings your estimated tax is $500 or more, you must make estimated tax payments using Form 1040-ES vouchers unless the withholdings will cover at least 90% of your estimated 1997 liability or 100% (or 110%, as just discussed) of your 1996 liability. If withholdings will not cover the amount required under the 90% or 100% (or 110%) tests, you may pay the balance of the estimated tax with the first Form 1040-ES voucher or in four equal installments. The first installment is due April 15, 1997.

   If you are due a refund when you file your 1996 return, it may be credited to your 1997 estimated tax by making an election on your 1996 return. The IRS will credit the refund to the April installment of 1997 estimated tax unless you attach a statement to your return instructing the IRS to apply the refund to later installments.

   Members of a partnership declare their estimated taxes in their individual capacities. Each partner's estimate must include his or her share of the partnership income, whether actually paid or not.

   Farmers or fishermen. In figuring the required annual payment to avoid a penalty for 1997, a farmer or fisherman has to pay only 66⅔% of the 1997 estimated liability, rather than 90%. A penalty may also be avoided by paying 100% of the 1996 tax, provided a tax return covering a 12-month period was filed for 1996; the 110% test does not apply to a farmer or fisherman. To qualify as a farmer or fisherman under these rules, at least two-thirds of gross income must be from farming or fishing.
3. **When preparing your second, third, or fourth estimated tax installment.** If, during the year, your income, expenses, or exemptions change, refigure your estimated tax liability and adjust your payment schedule as shown in the Examples starting below. Increasing an installment payment cannot make up for an underpayment in a prior quarter; *see* Example 2. However, withholding from pay can be allocated equally over all four quarters and, thus, increased withholding may be applied to earlier quarters.

   If taxes paid in the previous installments total more than your revised estimate, you cannot obtain a refund at that time. You must wait until you file your final return showing that a refund is due.

   If your income has increased during the year, you may consider basing installments on the annualized method discussed on the next page.

EXAMPLES

1. Smith estimates a 1997 tax of $6,000. In April 1997, he pays an installment of $1,500. In June, he amends his estimate, showing a tax of $3,000 instead of $6,000. He refigures the installment schedule by dividing $3,000 by 4, which gives a quarterly payment rate of $750. As he paid $1,500 in April, the $750 overpayment covers his June obligation. By September 15, he pays $750; by January 15, 1998, he pays $750.

2. In September 1997, Jones finds that his estimated 1997 tax liability should be $25,000 rather than his original estimate of $20,000. He paid $5,000 as his April and June installments ($10,000 total). Under the amended schedule, he should have paid $6,250 per quarter ($25,000 ÷ 4), or $12,500 by June 16. Thus, there is a $2,500 underpayment ($12,500 – 10,000).

   To cover the underpayment of $2,500, which carries over to the third quarter, Jones's September installment must be at least $8,750 ($6,250 + $2,500). If less than $8,750 is paid, there will be an underpayment for the third quarter, as third-quarter payments are applied first to the carried-over underpayment of $2,500. The fourth-quarter installment, due by January 15, 1998, will be $6,250. The underpayments for the first two quarters may be subject to a penalty unless covered by one of the exceptions previously discussed.

¶27.2 Dates for Paying Estimated Taxes

The four installment dates for 1997 estimated tax are: April 15, 1997; June 16, 1997; September 15, 1997; and January 15, 1998. Later installments may be used to amend earlier ones; *see* the Examples at the end of ¶27.1. You do not have to file the January 15, 1998, voucher if you file your 1997 tax return and pay the balance of tax due by February 2, 1998.

If you use a fiscal year. A fiscal year is any year other than the calendar year. If you file using a fiscal year, your first estimated installment is due on or before the 15th day of the fourth month of your fiscal year. Amendments may be made on the 15th day of the sixth and ninth months of your fiscal year with the final amendment on the 15th day of the first month of your next fiscal year. Your installments are also due then.

Farmers and fishermen. Farmers only have to make one installment payment, generally by January 15 of the following year. The payment for 1996 must be made by January 15, 1997, or farmers may file their 1996 returns by March 3, 1997, instead of making an estimated tax payment. To qualify under these rules, a farmer must receive two-thirds of his or her 1995 or 1996 gross income from farming.

Fishermen who expect to receive at least two-thirds of their gross income from fishing pay estimated taxes as farmers do.

¶27.3 Estimates by Husband and Wife

A married couple may pay joint or separate estimated taxes. The nature of the estimated tax does not control the kind of final return you file.

Where a joint estimated tax is paid but separate tax returns are filed, you and your spouse can decide on how to divide the estimated payments between you. Either one of you can claim the whole amount, or you can agree to divide it in any proportion. If you cannot agree, the IRS will allocate the estimated taxes proportionally according to the percentage of total tax each spouse owes.

If separate estimated taxes are paid, overpayment by one spouse is not applied against an underpayment by the other when separate final returns are filed.

A joint estimated tax may be made by a husband and wife only if they are both citizens or residents of the United States. Both must have the same taxable year. A joint estimate may not be made by a couple who are divorced or legally separated under a decree. If a joint estimate is made and the spouses are divorced or legally separated later in that year, they may divide the joint payments between them under the above rule for spouses who file separately.

Responsibility for paying estimated tax rests upon each spouse individually. Each must pay if individually required by the rules.

If a joint estimated tax is made and one spouse dies, the estate does not continue to make installment payments. The surviving spouse is required to pay the remaining installments unless he or she amends; *see* ¶1.12. Amounts paid on the joint estimate may be divided as agreed upon by the spouse and the estate of the deceased. If they do not agree, the IRS will apportion the payments according to the percentage of the total tax owed by each spouse.

¶27.4 Final Payment for 1996

That you paid an estimated tax for 1996 does not excuse you from filing a tax return on or before April 15, 1997. You must file a final return and pay the difference between the total of your withholding plus your estimated tax payments and your final tax. If your 1996 tax is less than your withholdings and payments, you get a refund from the IRS *or* you can apply the overpayment towards your 1997 estimated tax. You may also split up the amount due you. You may take part of the overpayment as a refund. The other part may be credited to your estimate of 1997 taxes. You may get interest only on the part refunded.

Check your mathematics before you apply an overpayment as a credit on your next year's estimate. If you apply too much, the amount credited may not be used to offset any additional tax due that the IRS determines you owe. For example, your 1996 return shows a $500 refund due, and you apply it towards your 1997 estimated tax. However, the IRS determines that you overpaid $200, not $500. You will be billed for the additional $300 tax, plus interest due; you may not offset the extra tax with the credited amount.

¶27.5 Penalty for Underestimating

Penalties are figured separately for each installment date (¶27.4). This means that if, after taking into account withholdings from your pay, you underpay an installment, you may owe a penalty for that quarterly period even though you overpay later installments to make up the difference. The penalty for each period runs from the installment due date until the amount is paid or until the regular filing date for the final tax return, whichever is earlier.

Withholding payments are treated as if they were payments of estimated tax. In applying them, the total withholdings of the year are divided equally to each quarterly installment date unless you want to show the actual payment dates; then they are applied in the quarter they are actually withheld.

Figure the 1996 penalty for yourself on Form 2210 or let the IRS do it. You can use Form 2210 to determine any 1996 penalty, but the IRS encourages taxpayers to let the IRS compute any penalty. The IRS will figure the amount of any penalty and bill you for the amount if you do not complete Form 2210.

There is no penalty and you do not have to file Form 2210 if the tax liability shown on your 1996 return is less than $500, after taking into account withholdings. There also is no penalty if you had no tax liability for 1995, you were a U.S. citizen or resident for all of 1995, and your 1995 taxable year included 12 full months.

You *must* attach Form 2210 to your return if: (1) you use the annualized income exception; (2) you do not allocate wage withholdings in four equal amounts; (3) your required estimated tax payment for 1996 is based on 100% or 110% of the prior year's tax and a joint return is filed for either the prior year or the current year but not both, or (4) you claim a penalty waiver; *see* below for waiver rules.

If you *underpaid* for any quarter, the amount of the underpayment reduces the payment made in the following quarter. That is, an underpayment of one quarter is carried over to succeeding quarters on Form 2210. If you underpay for a quarter, any payment you make after that installment date will be applied first to the earlier underpayment. Thus, even if you make the required payment for a quarter, you could still be subject to a penalty for that quarter because your payment is applied to a prior underpayment.

If you *overpaid* in any quarter, the excess carries over to the next quarter. The excess cannot be used to make up an underpayment of the prior quarter. However, these rules apply only to installment payments made with Form 1040-ES vouchers. They do not apply to withholdings, which are allocated equally over the year so that withholdings late in the year can reduce an underpayment for an earlier calendar quarter.

Waiver of penalty for hardship, retirement, or disability. The IRS may waive the penalty if you can show you failed to pay the estimated tax because of casualty, disaster, or other unusual circumstances.

The IRS may also waive a penalty for a 1996 underpayment if in 1996 or 1995 you retired after reaching age 62 or became disabled, and you failed to make a payment due to reasonable cause and not due to willful neglect. This rule would apply to a 1997 underpayment if you became disabled or retired (after age 62) in 1996 or 1997. To apply for the waiver, attach an explanation on Form 2210 with applicable documentation.

Withholdings Cover Prior Underpayment

You have a choice in allocating withholdings from pay or other income that is subject to withholding: (1) You may treat your entire year's withholdings as having been withheld in equal amounts for each quarter; or (2) you may allocate to each quarter the actual withholdings paid for that quarter. Also, if toward the end of the year, you find that you have underestimated for an earlier quarter, ask your employer to withhold an extra amount which may be allocated equally over the four quarters. This way, you may eliminate the underestimate for the earlier quarters.